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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1694

MOBIL OIL CORPORATION,
Petitioner,
v.
HARRY LIGHTCAP, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the Supreme Court of the State of Kansas

BRIEF OF THE NORTHERN DISTRIBUTOR GROUP AS *AMICI CURIAE*

Interstate Power Company
Iowa Electric Light and Power Company
Iowa Power and Light Company
Iowa Public Service Company
Iowa Southern Utilities Corporation
Metropolitan Utilities District of Omaha
Minnesota Gas Company
The Nebraska Natural Gas Company
North Central Public Service Co.
Northern States Power Company
Northwestern Public Service Company

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The above-named eleven utility companies respectfully submit this brief as *amici curiae* in support of the petition for writ of certiorari filed in this case on behalf of the Mobil Oil Corporation (Mobil).

STATEMENT

The Northern Distributor Group adopts the sections of Mobil's Petition setting forth Opinion Below, Jurisdiction, Question Presented, Statutory and Constitutional Provisions Involved, and Statement of the Case. The Northern Distributor Group companies supplement the petition with a statement of their interests in this case and of their reasons this Court should grant the petition and review the decision of the Supreme Court of the State of Kansas.

STATEMENT OF INTERESTS OF *AMICI CURIAE*

The eleven companies in the Northern Distributor Group sell natural gas to over one million residential, commercial, and industrial consumers in the States of Nebraska, Iowa, Minnesota, South Dakota and Wisconsin. The major supplier of gas to these companies is Northern Natural Gas Company (Northern), which owns and operates an extensive interstate pipeline transmission system, extending from fields of production in Texas, Oklahoma, and Kansas, to points of delivery to Northern's customers, including the Northern Distributor Group companies, in the Upper Midwest area of the United States. Northern's transportation services, sales to its customers, and rates charged to its customers are regulated by the Federal Power Commission under the Natural Gas Act.

A major source of natural gas for Northern is the Kansas Hugoton Field, one of the largest natural gas fields in the United States. Within that field, the major seller to Northern is Mobil, which operates several hun-

dred producing wells. Since June 7, 1954, Mobil's sales to Northern have been regulated by the Federal Power Commission under the Natural Gas Act; and at all times since that date, the maximum rate Mobil has charged and can charge Northern has been fixed or prescribed by Commission orders and decisions under Sections 4 and 5 of that Act.[1]

Commission rate regulation applies to 100 percent of the volume sold and delivered to Northern, but revenues ultimately are divided between the seven-eighths retained by Mobil, as producer, lessee, and "working interest" owner, and the one-eighth paid over to lessors who own the "royalty interest." Since the advent of federal rate regulation, Mobil has paid or tendered to the royalty owners payments computed on the basis of rates that became final under Commission orders.

However, for many years, royalty owners have claimed that their interests and payments are wholly unaffected by federal rate regulation, and that they are entitled to payments computed on the basis of alleged "market values" significantly higher than Commission-prescribed rates. Extensive, protracted litigation in the Kansas courts over this issue has culminated in the decision of the Supreme Court of Kansas in favor of the royalty owners.

In substance, that decision is that federal rate regulation is irrelevant and immaterial to the "market value" and rate to be used to compute royalty payments; and in force and effect, the result is a judgment that will require payments on bases far exceeding the Commission-

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[1] See *Socony Mobil Oil Co., Inc.*, 31 FPC 1101 (1964); *Hugoton-Anadarko Area Rate Case: California* v. *Federal Power Commission*, 466 F.2d 974 (9th Cir. 1972); *Just and Reasonable National Rates for Sales of Natural Gas From Wells Commenced Prior to January 1, 1973*, 54 FPC —— (Opinion No. 749, issued December 31, 1975), on review *sub nom. Tenneco Oil Company* v. *Federal Power Commission*, No. 76-2960, Fifth Circuit).

prescribed rates. Thus, the excess payments for past periods would be at levels exceeding the just and reasonable rates by 35 to 50 percent; and if the holding below were applied to current deliveries, the excess payments to royalty owners could be on bases or claimed "values" some four to five times the maximum ceiling rate for "flowing" gas produced in the Kansas Hugoton Field and sold to interstate pipelines.[2]

The Northern Distributor Group is gravely concerned that such excess payments for the royalty interest will move directly up the pipe to distribution companies and ultimate consumers of natural gas. The amounts so attributable to one-eighth of the natural gas purchased by interstate pipelines can be many millions of dollars because (1) of the hugh volumes purchased in the Hugoton Field, and (2) of the increasing differential between the Commission-prescribed rates and alleged "market values" that may be established by reference to unregulated sales of natural gas.

Under Commission procedures, producers paying such claims may apply to the Commission for "individualized relief" to recover these "costs" through increased rates charged to pipelines.[3] At the same time, the Commission

[2] The current maximum ceiling rate prescribed by the Commission for producers' sales of "flowing" gas is 29.5 cents per Mcf. See opinions cited in footnote 1, *supra*. In contrast, prices in new contracts in the "intrastate market" in Kansas averaged $1.45 per Mcf during the first quarter of 1977, with a high of $1.67 per Mcf. See FPC Release No. 23143, issued May 17, 1977, and accompanying Staff Report, "Intrastate Natural Gas Prices of Jurisdictional Natural Gas Companies Selling More Than One Million Mcf Per Year in Interstate Commerce," page 9.

[3] The courts have recognized the right of producers to seek such "individualized" special relief, even though adjustments to existing rates have been held "premature" until such time as a producer is confronted, as here, with a "final judgment." See *Placid Oil Company* v. *Federal Power Commission*, 483 F.2d 880 (5th Cir. 1973), aff'd *Mobil Oil Corporation* v. *Federal Power Commission*, 417 U.S. 283 (1974). To date, the Commission has denied such petitions, but the questions so raised remain unresolved by the courts of appeals. See FPC Opinion No. 753, —— FPC —— (issued January 30, 1976), on review *sub nom. Pennzoil Producing Company* v. *Federal Power Commission*, Nos. 76-1626, et al., 5th Circuit.

fixes its national ceiling rates on the basis of composites of producers' costs; as judgment payments and increased royalty payments become embedded in producers' costs, these increases automatically will be translated into higher ceiling rates, and thus, higher charges by producers to pipeline purchasers.[4] Both types of increases, and the future spiral effect, inevitably would be passed on by pipelines as "costs of purchased gas" to their customers, including the Northern Distributor Group companies; so that, regardless of all of the regulatory niceties, the ultimate payers of these windfalls would be the interstate consumers.

Conversely, if facts and law would permit a decision that such excess payments should be "absorbed" by producers, there would be equal, if not worse, impact on the interstate natural gas industry. Producers, not royalty owners, bear all costs of production, and revenues generated from natural gas sales are a primary source of the producer's funds for workovers, maintenance of wells, repairs of gathering systems, and exploration and development of new supplies. If revenues and such funds are siphoned off in windfall payments not recovered in rates, then the practical dollar impact can mean only (1) earlier abandonment of existing and old wells as uneconomic, and (2) reduction in funds available for exploration and development. The interstate industry and consumers thus would suffer either way. If they do not

[4] As to the methodology used by the Commission in fixing producer rates, including a "cost" component or allowance for royalty payments, see *Placid Oil Company* v. *Federal Power Commission*, 483 F.2d 880 (5th Cir. 1973), and *Shell Oil Company* v. *Federal Power Commission*, 520 F.2d 1061 (5th Cir. 1975), *reh. den.*, 525 F.2d 1261, *cert. den.*, 426 U.S. 941 (1976).

reimburse producers for the increased royalty costs, they still will be adversely affected by an accelerating decline in natural gas supplies available for interstate transmission to and local distribution in the consuming states.

For these reasons, the Northern Distributor Group has an immediate and direct interest in this case which is not represented by the producer petitioner or the royalty interests. In our view, the case presents important federal questions decided erroneously below, warranting review and resolution by this Court.

REASONS FOR GRANTING THE WRIT

This case presents federal questions which are critical to the administration of the Natural Gas Act and which should be resolved promptly by this Court. These questions have been decided by the Kansas state courts in a manner adverse to the interstate natural gas industry and the interests of consumers supposedly protected by the Natural Gas Act. The state courts also have decided those questions in a manner conflicting with decisions of this Court as to federal pre-emption of state authority and state law by the Natural Gas Act and in a manner inconsistent with applicability of the Supremacy and Commerce clauses to the subject of natural gas regulation:

1. The impact of the decision below extends far beyond supposedly private litigation in a state court between the royalty owner plaintiffs and a producer defendant over payments of royalty. The decision below apparently is the first by the highest court of a state resolving a question that has been variously considered and unresolved by state and federal courts for more than a decade, *i.e.*, whether payments for royalty interests attributable to sales of natural gas regulated by the Federal Power Commission are limited by the Commission-prescribed rates or must be made on the bases of higher "market values" determined by state courts in private litigation.

Either way this question ultimately is resolved, the answer has a direct impact on all producers selling natural gas under leases containing so-called "market value" clauses, all interstate pipelines purchasing from such producers, all distribution customers of such pipelines, and all consumers of natural gas dependent upon this series of interstate sales and transmission. As shown, *supra*, successive steps in the administration of the Natural Gas Act are involved, and the ultimate detrimental impact of the decision below can be either spiralling rates for interstate consumers or deterioration of supplies available for the interstate market. While the litigation below is in the framework and guise of private "contractual" suits, the importance and impact of the decision reach far beyond the borders of Kansas.

Royalty owners are not "natural-gas companies" as those words are defined in the Natural Gas Act. *Mobil Oil Corporation* v. *Federal Power Commission*, 463 F.2d 256 (D.C. Cir.), *cert. den.*, 406 U.S. 975 (1972). This, however, by no means resolves the federal questions raised and preserved by Mobil below and now decided adversely to the interests of the regulated natural gas industry and ultimate consumers. Specifically, those questions are whether Congress, by passage of the Natural Gas Act, effectively pre-empted the field so that Commission-prescribed rates operate as a ceiling on "value" or "price" in the interstate market, barring state imposition of higher "market values" for computing royalty payments, and whether such acts by the state courts are in derogation of the federal regulatory scheme and violative of the Supremacy and Commerce clauses (see 463 F.2d at 265-266).

In one form or another, these questions have been recognized but left unresolved by the Commission and lower courts for years. Now, however, they have been answered and answered erroneously. If left standing and unre-

versed, such answers apparently will provide widely-applicable precedent and will trigger the inevitable resulting rate increases, described *supra*, with spiralling and accelerating effects beyond the control of Commission regulation under the Natural Gas Act. The decision below thus presents a very real, critical impact on the administration of the Natural Gas Act and raises issues now ripe for timely resolution by this Court if consumers are to have the stability of rates and protection from windfall increases intended by Congress.

2. The royalty interest is not immune, as held below, from the limitations and restraints of Commission-prescribed ceilings under the Natural Gas Act. The purported "market" and "values" found below have been non-existent since the passage of the Natural Gas Act in 1938 for "royalty" attributable to producers' sales in interstate commerce for resale. Such sales are made under long-term contracts, under certificates of indefinite duration issued by the Commission under Section 7 of that Act, and under continuous regulation of rates for 100 percent of the sales volume under Sections 4 and 5 of the Act. The statute and Commission orders thus are a system wholly supplanting any other "market" as to such sales and any other "value" as a lawful basis for computing royalty. Contrary to the holding below, the restraint on the royalty "interest" and the "value" flows, as a matter of law, by reason of pre-emption by the federal regulatory system and the accord that must be given that system under the Supremacy and Commerce clauses.

The questions raised have not been considered by this Court, but the holding below cannot be reconciled with the decisions of this Court as to relation of the Natural Gas Act to state law and state control. Thus, this Court has held that federal rate regulation is not inhibited or limited by impact on royalty, lease "value," or other local property interests (*Federal Power Commission* v.

Hope Natural Gas Company, 320 U.S. 591 (1943)); that economic reality, rather than the form or substance under state property law, must govern decisions as to the reach of the Natural Gas Act to specific transactions (*United Gas Improvement Company* v. *Continental Oil Company*, 381 U.S. 392 (1965); *California* v. *LoVaca Gathering Company*, 379 U.S. 366 (1965)); and that state action, whether direct *or indirect*, must be barred if the effect is in conflict with, or frustration of, the regulatory system established by the Natural Gas Act (*Northern Natural Gas Company* v. *State Corporation Commission of Kansas*, 372 U.S. 84 (1963); *Natural Gas Pipeline Company* v. *Panoma Corporation*, 349 U.S. 44 (1954)). Plainly, the court below disregarded the thrust, import and controlling applicability of these decisions and has committed error that now can be corrected only by this court if the adverse impact on interests supposedly protected by the Natural Gas Act is to be avoided.

3. The decisions of this Court cited *supra* are applications of the principles mandated by the Supremacy and Commerce clause when, as in this instance, Congress has established a pervasive, continuous system of regulation to protect the public interest. Those decisions also are an index to ingenious arguments grounded in state contract or property law and designed to open loopholes in the federal system. This Court has, without exception, found the conjured loopholes non-existent and repeatedly said that the Natural Gas Act does pre-empt and bar these refuges sought in state law and override results supposedly consistent with state contract or property law but in conflict with the Natural Gas Act and effective Commission regulation. These principles were and are applicable to the issues before the state courts below, but they have been disregarded.

As properly applied here, those principles mean that there can be no "market value" outside of the federal

rate system controlling and increasing the costs of what is in reality one-eighth or more of the commingled natural gas stream to which Commission rate jurisdiction attaches from the date of initial delivery in interstate commerce until the date the Commission authorizes "abandonment" of wells under Section 7(b) of the Act. State law and state courts cannot carve out an "interest" and proclaim increasingly higher "values" to be paid by regulated producers and ultimately by all downstream rate-payers. This is particularly true where, as here, there was only an interstate market when deliveries commenced years ago and when the lease instruments upon which the claims rest were made subject to all valid laws, regulations, and regulatory orders that were or became applicable to such transactions. In brief, the Kansas courts simply have seized upon latter-day increases in "value" in the newer intrastate market to provide windfall revenues to interests who bore and bear no past or current costs, and do so in a manner and in a system under which these excessive "royalties" must be borne by interstate consumers.

Such results undermine the Natural Gas Act, frustrate the system of federal regulation, conflict with the decisions of this Court, and should be ended now, in timely fashion, by this Court's review and reversal of the decision of the Supreme Court of the State of Kansas.

CONCLUSION

For the foregoing reasons, the petition in this case should be granted.

Respectfully submitted,

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